



**An Overview of Public  
Employee Post-Employment  
Benefits and Recent Concerns  
About How to Provide  
and Pay for Them**

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Requested by the Governor's Public  
Employee Post-Employment Benefits Commission

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# **Funding the Golden Years **in the** Golden State**

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**On December 28, 2006 Governor Arnold Schwarzenegger established, by Executive Order S-25-06, the Public Employee Post-Employment Benefits Commission to address unfunded post-employment benefits. By January 1, 2008 the Commission will send a report to the Governor and Legislature that will:**

Identify the full amount of pension, retiree health care and other post-employment benefits for which California governments are liable and which remain unfunded.

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Evaluate and compare various approaches for addressing governments' unfunded retirement health care and pension obligations.

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Propose a plan to address governments' unfunded retirement health care and pension obligations.

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The Commission includes twelve members: six, including the chairperson, appointed by the Governor, three appointed by the Speaker of the Assembly, and three appointed by the Senate President Pro Tem.

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The California Research Bureau was requested by the Commission to conduct a background study of public employee post-employment benefits in California, key issues and concerns that have shaped recent debates about providing and funding those benefits, and a framework for future discussions.

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Subsequent California Research Bureau reports will provide a comparative analysis that examines the design and costs of post-employment benefits in relation to benefits offered to public employees in other states and a review of the academic literature on various types of post-employment benefit plans and an examination of the outcomes of reforms that have been implemented throughout the United States.

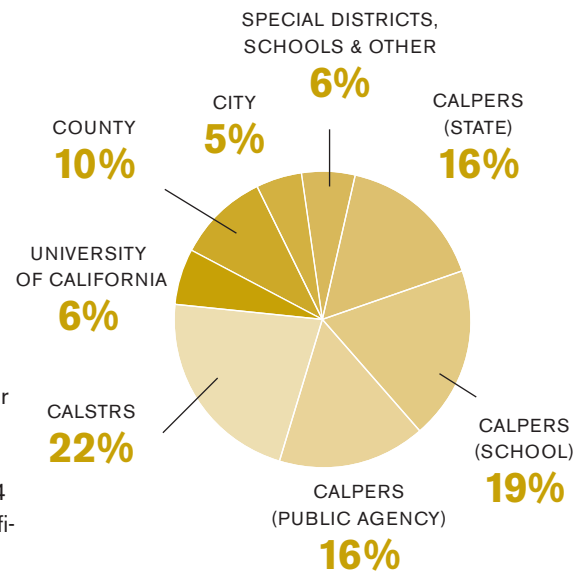
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# 1. Public Employees and Public Employee Post-Employment Benefits in California

## Who Are California's Public Employees?

State and local governments in California employed approximately 2.2 million workers (about 15 percent of the state's work force) in January of 2007.<sup>1</sup> Of these, approximately 22 percent are state employees and 78 percent work for the counties, cities, school districts and special districts.

In fiscal year (FY) 2003/04 there were nearly four million members in California's public employee retirement systems.<sup>2</sup> Approximately 64 percent of these members were active employees and 24 percent were "annuitants" – retirees or the beneficiaries of deceased public employees receiving an allowance, or annuity. Another 12 percent were "inactive" members who were no longer employed and contributing to the retirement systems, but were not drawing a retirement allowance and had not received a refund of their retirement contributions.



**Figure 1. California Public Employee Retirement System Membership Fiscal Year 2003/04**

Sources: "Public Retirement Systems Annual Report," Fiscal Year 2003/04, California State Controller's Office, July 31, 2006, and the 2003/04 Comprehensive Annual Financial Reports for CalPERS, CalSTRS, and the University of California Retirement System.

As Figure 1 indicates, the majority of public employees in California, approximately 79 percent, are in state retirement systems (California Public Employees' Retirement System (CalPERS), California State Teachers' Retirement System (CalSTRS) and the University of California Retirement System).

## What Post-Employment Benefits Are Made Available To The State's Public Employees?: Pension And Other Post-Employment Benefits (OPEB)

Post-employment benefits fall into two general categories. The first of these is pension benefits that provide continuing income to employees after they retire. The second category has been broadly defined as "other post-employment benefits" or OPEB. OPEB includes healthcare as well as



other forms of post-employment benefits provided separately from a pension plan such as vision and dental care, life insurance and long-term care.

## Defined Benefit Pensions

Public employers in California typically provide primary pension benefits through a defined benefit (DB) plan. In contrast to defined contribution (DC) pension plans in which retirement income depends on the amount accumulated in employees' individual accounts, defined benefit plans guarantee a specific level of retirement income that is calculated based on employees' age, years of service and salary. For example, in a retirement system that provides two percent per year at age 55, members with 20 years of service may retire at age 55 and receive an unadjusted benefit of approximately 40 percent (two percent multiplied by 20 years of service) of their final salary.

Plans typically allow members to opt for a reduced benefit in exchange for a continuing allowance for surviving beneficiaries. For most public employees in California, retirement income from defined benefit plans is indexed to inflation or adjusted on an ad hoc basis. Defined benefit plans also generally provide lump-sum death benefits and disability benefits that are determined based on employees' years of service and salary.

Employer-sponsored pensions that are funded wholly or partially by employers are one component of what is often described as the three-legged stool of post-employment income that also includes personal savings and Social Security benefits. With respect to personal savings, California's public employers generally offer some form of tax advantaged deferred compensation plan such as a 401(k), 457 or a 403(b) plan, but unlike private sector employees, not all public employees participate in Social Security. State safety employees and teachers do not contribute to Social Security.

## Pension System Funding

Defined benefit retirement system funds are typically held in some form of trust that can only be tapped to pay member benefits and the costs of administering the pension plan. Defined benefit retirement systems receive income from returns on invested assets and contributions from employers and employees. The majority of retirement systems' income generally comes from investment returns. As an example, during the five-year period from fiscal year 2002 through 2006, investment returns accounted for approximately 67 percent of the income in the CalPERS Public Employees' Retirement Fund.<sup>3</sup> Employer and employee contributions during that period averaged 20 percent and 13 percent of the fund's total income, respectively.

Unlike private sector defined benefit plans which tend to be "non-contributory" (i.e., do not require employees to contribute), public employees generally contribute to defined benefit plans at a fixed rate that varies among different types of employees and retirement systems. In some cases, collective bargaining agreements may specify that employers pay employees' contributions for a period of time.

Employer contributions vary from year to year depending on actuarial calculations that determine the size of the pension fund that will be needed to pay current and future benefits. Actuarial calculations are based on projections of fund investment earnings, mortality, the number of retirees and beneficiaries and other factors. Actuaries calculate the contribution amount needed to cover the liability that accrues each year and the amount needed to pay an installment on any unfunded liability. If the fund's assets are less than the projected liabilities, the plan is generally considered to be under-funded.

In some cases, bonds are used to finance unfunded pension liability. According to a 2003 report, state and local governments in the United States raised more than \$18 billion through pension bonds between 1990 and 2002.<sup>4</sup> Pension obligation bonds are generally issued by the plan sponsor or pension system entity and backed by tax revenues. Proceeds are made available to pension fund managers for investment. However, because there are no guarantees that a pension system will remain fully-funded after the sale of a bond, some governments may end up paying both pension bond debt service and new unfunded liabilities.<sup>5</sup>

## Public Employee Defined Benefit Retirement Systems in California

The California State Controller's Office listed 84 defined benefit pension systems in its most recent annual report on public employee retirement systems.<sup>6</sup> These include:

- The Public Employees' Retirement Fund (PERF) administered by CalPERS for State, public agency, and classified school employees;
- The Legislators' (for legislators serving prior to November 7, 1990) and Judges' Retirement Systems, also administered by CalPERS;
- CalSTRS administers a plan for public K-12 and community college teachers;
- The University of California Retirement System for University of California employees;
- 20 systems operating under the County Employees Retirement Law of 1937;
- Two independent county system (San Francisco and San Luis Obispo counties);
- 32 city systems;
- 25 special district systems; and
- One school district system.

## **Other Post-Employment Benefits (OPEB)**

### **State Retirees**

For state retirees with 20 or more years of service, the state pays 100 percent of a weighted average of premium costs for single enrollees in the four basic health plans with the largest state employee enrollment during the prior year and 90 percent of a similar weighted average for premiums to cover eligible family members of retirees. For a single enrollee the 2007 state monthly contribution of \$439 covers the entire premium for all Medicare plans and all basic plans with the exception of the Kaiser out-of-state plan, one association plan and the PERSCare PPO for which the single annuitant's portion of the monthly premium is \$323. For annuitants enrolled as a family the 2007 state monthly contribution is \$1,042, which covers all Medicare plans. The family enrollee's out-of-pocket monthly premium cost for basic plans ranges from a low of \$2 for the Kaiser plan to \$939 for PERSCare.

State retirees with less than 10 years of service generally receive no employer health care contribution for themselves or family members. Those who retire with ten years of service receive 50 percent of the state contribution. This increases by 5 percent for each year of service until the 100 percent level is earned after 20 or more years of service. State employees hired prior to 1985 receive the full state contribution upon retirement regardless of years of service. At age 65, state retirees eligible for Medicare are required to switch to a CalPERS-sponsored supplement to a Medicare plan.

In addition to health care, state retirees are eligible to receive dental benefits and, as of April 1, 2007, participate in a retiree vision program. In addition, all California public employees, retirees, spouses, parents and parents-in-law are eligible for the CalPERS Long-Term Care Program. This includes teachers, school employees, University of California and California State University employees and

retirees, county and city employees and retirees, Judges, Legislators, and all other California public employees and retirees.

The CalPERS Long-Term Care Program is funded entirely by premiums paid by participants. In April 2007, premiums for the program were raised by five percent for younger members to as much as 47 percent for older members to cover future liabilities.<sup>7</sup> This increase represents a trend among long-term care plans that may be explained by poor stock market returns in the early part of the decade, higher than expected rates of policy renewals and medical advances that have increased life expectancies beyond the plan's actuarial assumptions.<sup>8</sup>

### **University of California**

Similar to state retirees, University of California retirees with 20 or more years of service receive 100 percent of the University's maximum retiree health contribution. In 2006, the maximum contribution covered all but \$18 to \$27 of monthly HMO premiums and all but \$70 to \$75 of monthly premiums for preferred provider organization (PPO) and point of service (POS) plans.<sup>9</sup>

University of California retirees with less than 10 years of service generally receive no health contributions for themselves or family members. Those who retire with ten years of service receive 50 percent of the University of California contribution. This increases by 5 percent for each year of service until the 100 percent level is earned after 20 or more years of service. At age 65, University of California retirees eligible for Medicare are required to switch to a plan that supplements Medicare.

In addition to health care, retirees are eligible to enroll in a University of California sponsored dental plan, a group legal plan and accidental death and dismemberment insurance. Retirees may also enroll in the CalPERS Long-Term Care Program.

### **Counties, Cities, Special Districts, School Districts, and Teachers (K-12 and Community College)**

The California State Association of Counties conducted a survey of county officials to examine retiree health benefits in September 2005.<sup>10</sup> Of the 49 counties that responded, 48 reported that retired employees are eligible for health benefits. All but six of the 48 provide health care benefits to retirees over the age of 65.<sup>11</sup>

A 2006 survey conducted by CalSTRS found that of the approximately 35 percent of districts who responded, 81 percent provided full or partial payment of retired teachers' health care coverage.<sup>12</sup> Only 14 percent, however, provided any contribution for retirees over the age of 65.<sup>13</sup>

In the course of conducting research for this report, the California Research Bureau was not able to find similar surveys of health benefits for city and special district employees.

### **Funding Other Post-Employment Benefits (OPEB)**

Currently, most public employers fund OPEB on a "pay-as-you-go" basis, which means that they make payments to health (or other benefit) plans or providers as payments come due rather than pre-funding OPEB by setting aside funds that can be invested and used to pay for future benefits. For example, the September 2005 survey of California counties found that only four of the 49 responding counties reported setting aside funds to pay for future OPEB.<sup>14</sup>

This situation may change, however. As public employers begin to comply with new Governmental Accounting Standards Board (GASB) rules that require unfunded OPEB liabilities to be accounted for and reported much like pension liabilities already are, there may be pressure to begin pre-funding OPEB.

In 1988, AB 1104 (Elder, Chapter 331, Statutes of 1988) established the Annuitants' Health Care Coverage Fund to pre-fund health care benefits for annuitants (retirees and their beneficiaries) covered by the Public Employees Medical and Hospital Care Act (i.e., CalPERS). Although the fund has remained dormant since its establishment,<sup>15</sup> on March 1, 2007, CalPERS announced the formal launch of the California Employers Retiree Benefit Trust Fund that will allow public employers that contract with CalPERS for employee health benefits to contribute to the fund in order to pre-fund retiree health benefits. Pending legislation (AB 554, Hernandez, 2007) would expand the PERS OPEB pre-funding program to include public employers that do not contract with CalPERS for health benefits. AB 2863 (Karnette, Chapter 846, Statutes of 2006) amended the County Employment Retirement Law to allow counties to establish their own separate trust funds to pay obligations for retiree healthcare and other post-employment benefits.

# 2. Reasons For Recent Concerns About Post-Employment Benefits

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## New Accounting Rules For Health Care and Other Post-Employment Benefit (OPEB)

The Government Accounting Standards Board, which establishes standards of financial accounting and reporting for U.S. state and local governments, recently adopted new standards for health care and other post-employment benefits (OPEB). These new rules will likely illuminate significant unfunded liabilities for state and local governments.

GASB Statement Number 43 (Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans) and Statement Number 45 (Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions) establish accounting and reporting standards for OPEB that are similar to the standards that GASB established in 1994 for public employee pension plans.<sup>16</sup>

GASB's reasoning for the new standards is that OPEB, like pension benefits, are a part of the compensation that employees earn each year, and that the cost of providing public services today should reflect the cost of these future benefits.<sup>17</sup> The new standards, which were adopted in 2004, can be viewed as a reflection of broader concerns about financial disclosure, significant annual increases in health care costs and the continuing national debate over retirement security.<sup>18</sup>

Implementation of the new standards will occur in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999. Implementation is required:

- After December 15, 2006, for phase 1 governments (those with total annual revenues of \$100 million or more);
- After December 15, 2007, for phase 2 governments (those with total annual revenues of \$10 million or more but less than \$100 million);

- After December 15, 2008, for phase 3 governments (those with total annual revenues of less than \$10 million).

Although the provisions of the new GASB standards do not require governments to fund OPEB plans, they provide a framework for doing so. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due.

Experts predict that actuarially determined annual contributions for OPEB could be five to 10 times greater than current annual expenses that governmental employers pay to provide for those benefits.<sup>19</sup> According to a report published by the California Legislative Analyst's Office, the state's OPEB liabilities "are likely in the range of \$40 billion to \$70 billion – and perhaps more."<sup>20</sup>



## Credit Ratings May Be Affected by How OPEB Liabilities Are Managed

According to Fitch Ratings:<sup>21</sup>

- Despite significant fiscal impacts that will occur for governmental entities switching from pay-as-you-go to actuarial funding, meeting actuarial funding requirements for OPEB will “be a stabilizing factor and protective of credit over time.”
- An absence of action taken to fund or otherwise manage OPEB liabilities will be viewed as a negative rating factor.
- OPEB plan funding ratios are not expected “to reach the generally high levels of pension systems for many years, but steady progress toward reaching the actuarially determined annual contribution level will be critical to sound credit quality.”

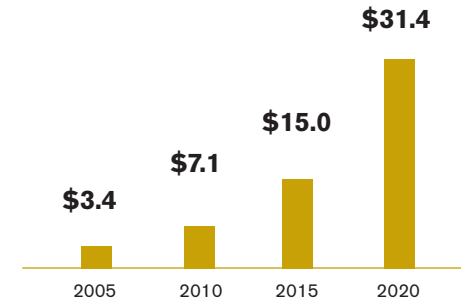
Moody’s Investors Service does not expect the new OPEB accounting and reporting standards and initial disclosures of large unfunded OPEB liabilities to cause “immediate and widespread rating adjustment.”<sup>22</sup> The credit-rating firm suggests that rating levels will likely be affected by changes in OPEB liability over time and the ability of a state or local government to manage that liability effectively. In particular, Moody’s plans to pay attention to factors such as:

- The unfunded accrued actuarial liability (UAAL)-to-covered payroll;
- Differences between required and actual contributions;
- Actuarial assumptions about medical costs and other key variables used to estimate OPEB liabilities; and
- Governments’ statutory and contractual flexibility to modify post-employment health benefits.

## The Rising Cost Of Retiree Health Benefits Compounds Concerns About The New GASB Standards For OPEB

According to a study commissioned by the California Health Care Foundation, the mid-range estimate of California state and local governments’ annual cost of providing health care to retirees (\$2.9 billion in 2004) will increase to \$31.4 billion in 2020 (figure 2).<sup>23</sup>

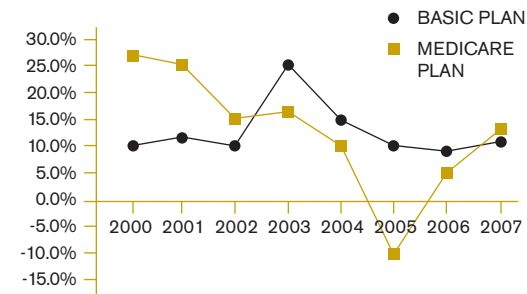
Explanations for the rising cost of retiree health benefits include demographic shifts, such as increases in the number of retirees and longer life expectancies, as well as significant recent increases in medical costs. These trends are apparent in California’s public sector. In the five years including 2000 through 2004, the number of annuitants (retirees and beneficiaries receiving an retirement allowance) reported by the state’s public employee retirement systems grew by 15% from 745,448 to 855,000.<sup>24</sup> In addition, from 2000 to 2007, the average annual premium increase was 12.7 percent for CalPERS basic health plans and 13.1 percent for CalPERS Medicare health plans (figure 3).<sup>25</sup>



**Figure 2. Estimated Annual Retiree Health Care Costs, California**  
Public Sector, Fiscal Year 2005–20 (\$ in billions)

**Notes:** The graph reflects a mid-range estimate of costs for cities, counties, schools, special districts and the state. It assumes funding on a “pay-as-you-go” basis, no significant policy changes, and costs based on recent trends.

**Source:** Center for Government Analysis, “An Analysis of Public Sector Health Care Costs in California,” p. 15, March 2006



**Figure 3. Annual Percentage Increase in CalPERS Basic and Medicare Health Plan Premiums, 2000–2007**

**Notes:** Figures for basic and Medicare plans reflect the overall increases for CalPERS HMOs, self-funded PPOs, and association plans.

**Source:** “Eight Year History of Premiums: 2000-2007,” CalPERS Health Benefits Branch, California Public Employees’ Retirement System

## Public Pension Actuaries' Assumptions About Medical Cost Trends

In order to examine the methodology that will be used to make assumptions about medical cost trends in actuarial valuations for health care benefits, the California Research Bureau contacted several actuaries that work with public pension systems throughout the U.S. All three of the actuaries who responded suggested that a higher, or "select" rate that reflects current annual increases in medical costs will be used initially, but that the rate will decline over time to an "ultimate" rate that reflects long-term expectations. Given recent double-digit increases in medical costs, some might question this assumption. Below are the actuaries' responses:

- "Generally it's expressed as a "select and ultimate" rate, with the first year rate set at the current health care cost trend rate (e.g., 12 percent) and then declining over a period of time (e.g., 10 years) to an ultimate rate reflecting the long-term expected rate (e.g., 5 percent). I'm sorry to say I haven't studied this closely enough to give you a sense of the range of assumptions, but I think the 12 percent to 5 percent rates are fairly typical. The rationale for the declining rate is that health care costs must ultimately slow, otherwise they will overwhelm the economy."
- "[With respect to the] medical trend factors we use to project future claims, [our firm's] standards right now call for these factors to start at about 10 percent per year for PPO & HMO plans, and grade down over a few years to about 5 percent as a long-term assumption. Prescription drug trend rates are a little higher, typically starting at 11 percent and grading down, again, to 5 percent. Vision and dental trends start much lower, say 5 percent to 7 percent. Other actuaries may use rates based on their own data that start and end a little lower or higher than the above, but I would expect their assumptions to be within

1 percent point of ours, typically. These rates are for typical plan designs. Various kinds of caps on employer obligations designed into the plan may allow the trend factors to be adjusted. For very large employers (e.g., State plans), trends may be partially based on a study of the plan's experience."

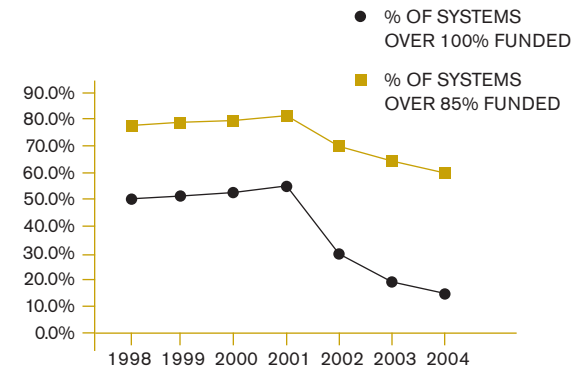
- "10 to 11 percent, falling to 5 to 6 percent over ten years."

## Unfunded Pension Liabilities

As public employee pension plan funding ratios have declined in recent years, unfunded pension liabilities have become a key concern in recent discussions about pension plans in California and nationwide. A pension plan's funding ratio is determined by dividing its liabilities (the cost of the benefits that have already been accrued by members) by its assets. A plan whose assets equal its liabilities is fully-funded. If assets are less than accrued liabilities, the plan has unfunded liabilities and is deemed under-funded.

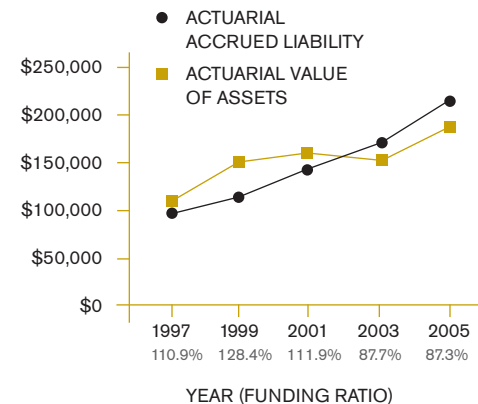
Advocates of defined benefit plans point out that funding ratios are not the only measure of the health of a pension plan. According to one analyst, "the critical factor in assessing the current and future health of a pension plan is not so much the plan's actuarial funding level, as whether or not funding the plan's liabilities create fiscal stress for the pension plan sponsor."<sup>26</sup>

A pension system with unfunded liability has been likened to a homeowner with a mortgage. For the homeowner, unfunded liability (the amount owed on the mortgage) is not necessarily a problem unless the mortgage payments become too much of a financial burden. Nonetheless, for a pension system, declining pension funding ratios are an indicator that contributions may have to be raised to pay for unfunded liabilities – a situation that could cause fiscal strain.



**Figure 4. Combined Funding Ratio of California's Public Employee Defined Benefit Retirement Systems**

Source: "Public Employee Retirement Systems Annual Reports," FYs 1996/97 through 2003/04. California State Controller's Office, July 31, 2006; <http://www.sco.ca.gov/ard/local/locrep/retirement/reports/>.



**Figure 5. CalPERS Public Employees' Retirement Fund Assets and Liabilities 1996 through 2005 (\$ in millions)**

Source: "CalPERS Comprehensive Annual Financial Reports," Fiscal Years 1998 through 2006, California Public Employees' Retirement System

## Funding Ratios Rose During the Late 1990s, But Then Declined

During the mid to late 1990s, as investment returns for U.S. public pension plans increased, the average funding ratio went from 81 percent in 1990 to 104 percent in 2000.<sup>27</sup> Since 2000, however, average funding ratios for public pensions have fallen steadily. In 2006, the average funding ratio for the 124 plans included in the Public Fund Survey was 85.9 percent.<sup>28</sup>

Similarly, Figure 4 reveals that the funding ratios for California's public employee defined benefit systems rose steadily during the 1990s, and then began to fall after 2001.<sup>29</sup> In the fiscal year that ended in June 1997, 41 percent of the state's 85 defined benefit systems had funding ratios that exceeded 100 percent. This figure rose annually, peaking in 2001 when 57 percent of the state's DB systems were fully funded. The percentage has fallen annually since.

In the fiscal year that ended in June 2004, the most recent year for which the California State Controller's Office data is available, only 16 percent of the state's defined benefit systems had funding ratios of 100 percent or greater. During that same year, only 61 percent of public employee defined benefit systems in California had funding ratios of greater than 85 percent, down from a peak of 80 percent of systems with 85 percent or greater funding ratios in 2001.

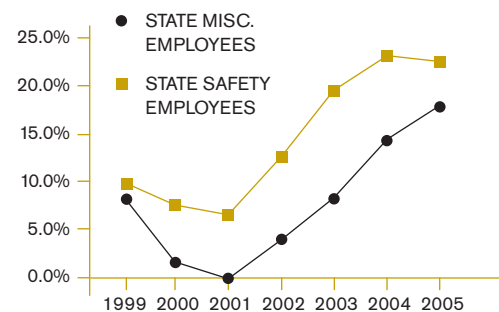
As Figure 5 illustrates, the funding ratio of the CalPERS Public Employees' Retirement Fund has followed a similar pattern. After a peak of 128.4 percent in 1999, the ratio declined every year to 2005, when it was 87.3 percent.

Recent increases in investment returns, however, suggest that the funding picture for California's public employee retirement systems may be improving. CalPERS, for example, earned a 15.4 percent return on investments in 2006, its fourth straight year with returns over 10 percent.<sup>30</sup>

## Analysts Point to Reduced Contribution Rates and Enhanced Benefits to Explain Increasing Unfunded Liabilities

Why did public pension plan funding ratios decline? A Fitch Ratings analyst suggests that the stock market gains of the 1990s and the relatively healthy funding positions of public pension systems led to decisions that had negative long-term consequences for pension funding.<sup>31</sup> Many pension systems enhanced benefits and, at the same time, implemented "funding holidays," reducing or eliminating employers' annual contributions. When the stock market began to decline, some plans reduced investment return assumptions, which further increased employer contributions.<sup>32</sup>

California's public employee pension systems have followed a trajectory that is consistent with these trends. Figure 6 shows that CalPERS contribution rates were particularly low in 2000 and 2001 – zero employer contributions for State Miscellaneous members in 2000 – but have increased annually since.



**Figure 6. CalPERS Employer Contribution Rates (as Percent of Payroll)**

Source: "CalPERS Comprehensive Annual Financial Reports," Fiscal Years 2000 through 2006, California Public Employees' Retirement System

California's public employees also received benefit enhancements in the early 2000s. One of the more notable enhancements resulted from the passage of SB 400 (Ortiz) in 1999, which contained a number of benefit enhancements for state employees including:

- Options that allowed new employees to join the more generous CalPERS first tier plan, and employees who had been required to participate in the second tier to buy into the first tier;
- An enhanced service retirement formula for first tier members that provides two percent of pay for each year of service at age 55, rather than at age 60 as it had been prior;
- Enhanced service retirement formulas for safety, peace officer/firefighter, and patrol members, and a provision that increased the limitation on service retirement benefits for peace officer/firefighter and patrol members, allowing them to receive 90 percent of final compensation in retirement.

There has been significant concern that local governments who followed the State's lead by adopting enhanced benefit provisions and reducing contributions are now struggling as they confront difficult choices about how to provide services while paying for unfunded pension liability.<sup>33</sup>

## Demographic Changes

German Chancellor Otto Von Bismarck is often credited as the architect of the first modern pension system. He established a system in the 1880s that allowed workers who reached the age of 70 to receive an annuity. The average life expectancy at the time was somewhere around 45 years of age. Today, of course, average life expectancies generally exceed retirement eligibility, and the changing demographics of the work force have emerged as another source of concern with respect to providing and funding post-employment benefits.

### More Retirees and Longer Retirement Periods

The oldest members of the Baby Boom generation born between 1946 and 1964 are just now reaching retirement age. This has led to predictions of a large increase in the number of retirees. Additionally, increasing life expectancies and predicted declines in the average retirement age have fueled speculation that average retirement periods will increase markedly, as will the length of time that post-employment benefits will need to be provided to the typical retiree. There is concern that if the design and funding mechanisms of post-employment benefit plans, and the actuarial assumptions used to determine contribution rates, do not take these shifts into account accurately, levels of unfunded liability could increase significantly.

### Public Employees In California are Older Than Private Sector Employees, and Joining the Retirement Rolls in Increasing Numbers

Because public sector employees tend to be older than their private sector counterparts, there is reason to believe that state and local governments will feel the impacts of these demographic shifts sooner. As Table 1 illustrates, compared to the private sector a higher percentage of government employees is over the age of 45.

Employee Population	% over 45 Years of Age
California State Misc. Employees (2005)	62%
California State Misc. Employees (2000)	60%
U.S. Average for Public Administration (1998)	59%
U.S. Average for all Occupations (1998)	34%

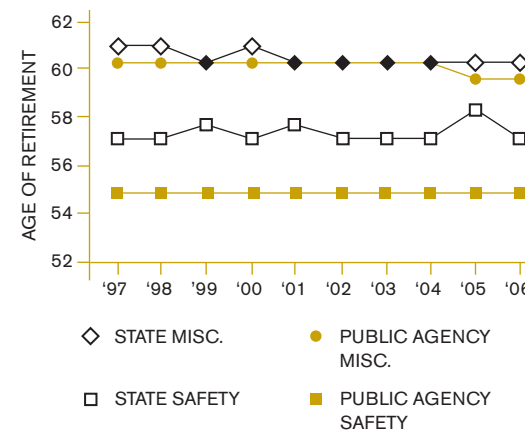
**Table 1. Percentage of U.S. and California State Miscellaneous Employees Over 45 Years of Age**

**Source:** CalPERS Comprehensive Annual Financial Reports for FY 2000/01 and 2005/06; and U.S. Bureau of Labor Statistics data published in "Gauging the Labor Force Effects of Retiring Baby Boomers" by Arlene Dohm (Bureau of Labor Statistics' Monthly Labor Review, July 2000).

For California State Miscellaneous employees, the largest single category of CalPERS members, this percentage rose from 2000 to 2005.

In addition to the aging of California's public employee population, there has been an annual increase in the number of public pension system annuitants (retirees and beneficiaries receiving an allowance). During the four years from 2000 to 2004, the number of annuitants increased by just over 100,000 (by approximately 15 percent) to 855,006.<sup>34</sup>

**The average retirement age of CalPERS State Miscellaneous and State Safety members has remained relatively stable, and the ratio of active California public employees to annuitants has actually increased in recent years.**



**Figure 7. Average Age and Years of Service at Service Retirement, State Miscellaneous and State Safety Employees, 1997 through 2004**

**Source:** CalPERS Annual Board Member Reports, Fiscal Years 1996/97-2005/06.

Figure 7 indicates that the age at retirement, at least for CalPERS state and public agency miscellaneous and safety employees, has remained fairly stable. Despite benefit enhancements that took effect in 2000 – enhancements that allow miscellaneous members to receive two percent of pay for each year of service worked at age 55 instead of at age 60 as had been the case previously – the average retirement age for state miscellaneous members fluctuated between 61 and 60 years of age through the end of fiscal year 2000, and then settled at age 60 for each year thereafter. The average retirement age for state safety members alternated between 57 and 58 years of age during the same time period.

Contradicting predictions about the growth of the retiree population relative to active members, in 2004, there were 3.1 active members (employees that are working and making contributions to the retirement systems) for every retiree or beneficiary receiving an annual allowance compared to only 2.2 in 2000.<sup>35</sup> This indicates that in recent years,

more workers are entering into state and local government employment than are leaving through retirement. It is likely, however, that this ratio will decline now that members of the Baby Boom generation are just beginning to retire.

## **The Decline Of Private Sector Defined Benefit Plans**

### **A Net Decline in Private Sector DB Plan Participation And The Number Of DB Plans**

The decline of private sector defined benefit (DB) plans has led some observers to question why DB plans remain the primary retirement vehicle for public employees. The number of private sector workers participating in DB plans was about 20 percent by 2002.<sup>36</sup> Even among older U.S. workers, those aged 47 to 64, the proportion participating in DB plans fell from 69 percent to 45 percent between 1983 and 2001. During the same period of time, participation in defined contribution plans (retirement plans in which the employer's contribution is generally set at a predetermined level, and the benefit is determined by the amount earned in employees' individual accounts) for workers in that age range rose from 12 percent to 62 percent.<sup>37</sup>

The number of private DB plans in the U.S. peaked at 175,143 in 1983, and then declined steadily to 56,405 in 1998.<sup>38</sup> Large companies such as IBM, Verizon, Sears, Hewlett-Packard, and Motorola did away with DB plans as large stock market declines eroded pension fund assets.<sup>39</sup> In recent years, the collapse of pension plans sponsored by large firms such as Bethlehem Steel, U.S. Airways and United Airlines have put a financial strain on the Pension Benefit Guaranty Corporation, a federal program that insures private pension plans.<sup>40</sup>

Despite the private sector trend away from DB plans, the percentage of public employees participating in DB plans has remained fairly constant at around 90 percent.<sup>41</sup> Some have argued that given the higher average cost that state and local governments pay for retirement and savings plans – government employers paid \$2.23 per employee hour worked in September 2004, 162 percent higher than the \$0.85 per employee hour cost for private-sector employers<sup>42</sup> – government employers should abandon traditional defined benefit plans.

Advocates of public employee defined benefits plans, however, counter the notion by pointing out that: (1) the decline of private sector DB plans has not been as drastic among large employers; (2) legal and regulatory factors make DB plans more advantageous for government employers; and (3) DB plans have significant benefits for the economy.

### **Advocates of Public Employee Defined Benefits Plans Suggest that Rumors of the Death of Private Sector DB Plans Have Been Exaggerated**

While there may have been a net decline in private sector DB plans in recent years, it appears that the prevalence of DB plans offered by large companies remains relatively high:

- According to a report by Towers Perrin, 79 percent of Fortune 100 companies in the U.S. provided some form of DB plan in 2006.<sup>43</sup>
- A 2002 Watson Wyatt analysis found that 50 percent of Fortune 100 companies in the U.S. provided a DB plan as their primary retirement plan, one-third offered some form of hybrid plan that combines elements of DB and DC plans, and only 17 percent offered a DC plan as a primary retirement benefit.<sup>44</sup>

- An Employee Benefit Research Institute report found that from 1985 to 1998, the number of employers with 10,000 or more employees offering DB plans as their primary retirement plan actually increased.<sup>45</sup>

### **Advocates of DB Plans Suggest that Differences in the Laws That Govern Private and Public Pension Benefits Explain Why Private Sector DB Plans Have Declined**

A National Association of State Retirement Administrators (NASRA) report suggests that government employers have not migrated to DC plans to the extent that private sector employers have because state and local government pension plans are exempt from the Employee Retirement Income Security Act (ERISA) whose provisions impose significant costs and administrative burdens on employers that sponsor DB plans.<sup>46</sup>

ERISA became effective in 1975. It established standards for DB plan participation, vesting, retirement and reporting. ERISA also requires private sector plans to make payments to the Pension Benefit Guaranty Corporation (PBGC) which insures private sector DB plans. State and local government pension plans are not subject to most ERISA regulations and are not required to pay contributions to the PBGC.

According to the NASRA report, ERISA has been a primary force that has driven the private sector away from DB plans. In particular, the report notes that ERISA amendments in the 1980s – the Multi-employer Pension Plan Amendments act of 1980, the Tax Equity and Fiscal Responsibility Act of 1982 and the Tax Reform Act of 1986 – “reduced or eliminated incentives to private sector employers offering DB plans, and increased the liability, expense, and regulatory requirements of maintaining a private sector DB plan.”<sup>47</sup>



## Some Researchers Suggest that Public Employee Defined Benefit Plans Benefit the Economy

A number of research findings suggest that a true assessment of the costs of DB pensions should take into account the significant economic benefits that DB funds generate. Researchers have argued that:

- Due to their size, diversification, and focus on long-term investment returns, DB pension funds stabilize U.S. and foreign financial markets.<sup>48</sup>
- Researchers have also noted “employer-provided pensions constitute the largest single source of funds for America’s financial sector.”<sup>49</sup>
- Employer-covered pensions relieve pressure to expand the federal Social Security System.<sup>50</sup>
- Public sector pension plans serve as a financial base for economic development in the states and communities they serve.<sup>51</sup>
- Because of their size and their focus on long-term returns, DB pension funds are uniquely situated to invest in venture capital, a segment of the market considered vital to long-term growth.<sup>52</sup> Pension funds are the largest source of funding for venture capital firms, providing more than 40 percent of the segment’s funding per year since 1990.<sup>53</sup>
- A recent California State University, Sacramento study that examined the economic impacts of CalPERS income payments to retirees and beneficiaries in 2006, found that CalPERS annuitants contributed almost \$11.8 billion and more than 78,000 jobs to the State’s economy.<sup>54</sup>

Arguments in Favor of DB Plans from: “NASRA White Paper: Myths and Misperceptions of Defined Benefit and Defined Contribution Plans” <sup>55</sup>	Arguments in Favor of DC Plans from: “The Gathering Pension Storm: How Government Pension Plans are Breaking the Bank and Strategies for Reform” <sup>56</sup>
Costs	
DB plans have lower administrative costs.	DC plans reduce the volatility of costs for employers.
Employee Preferences	
In plans that give employees the option, employees tend to choose DB plans over DC plans.	DC plans appeal to younger workers who have a longer investment horizon and a greater need for portability.
Portability	
Most terminating DC participants spend retirement savings rather than rolling them into new accounts.	DC plans are more portable because they can be rolled over into another plan if an employee changes jobs.
Value of the Benefit	
Professionally managed DB funds tend to generate higher returns and yield more sufficient retirement income.	DC plans allow employees the freedom to make investment decisions that are tailored to their own needs, and risk levels.
Work Force Management	
DB plans are an effective recruitment tool that can provide incentives that encourage employees to work longer or retire earlier, depending on the circumstances.	Unlike DC plans, DB plans create incentives for workers to retire prematurely, taking their productivity and skills with them.
Other	
DB plans help the economy by providing adequate retirement income to a significant portion of the work force, and reducing the likelihood that public sector retirees will rely on public assistance during retirement.	DC plans would eliminate the types of pension abuse and fraud that occur with DB plans. By taking investment decisions out of the hands of elected and appointed officials, DC plans eliminate the influence of political or other interests.

## DB vs. DC Debate

Concerns about the changing demographics of public employees, unfunded pension liabilities and the private sector's move away from traditional defined benefit pension plans have fueled an ongoing, nationwide debate about whether government employers should abandon the plans and establish defined contribution plans to replace them.

In 2005, a proposed California ballot initiative to prohibit new public employees from participating in defined benefit plans was eventually pulled amid opposition that centered largely on concerns about how disability and death benefits would be provided for public safety employees under a DC plan.

Arguments from two reports that represent opposite sides of the DC vs. DB debate are summarized in the table on the preceding page.

## Framing the Discussion

Arguments that have been raised in discussions about challenges confronting post-employment benefit plans for public employees and about proposals for reform appear to fall primarily into three broad categories: (1) comprehensiveness or adequacy; (2) costs; and (3) control. Distilling key issues into these categories does not necessarily bring solutions into view, but may provide a common framework or set of questions to guide discussions about all types of post-employment benefits and benefit plan provisions including service and disability retirement, survivor and death benefits, plan provisions such as cost-of-living increases, disability requirement and the calculation of final compensation, health care and other OPEB.

## Comprehensiveness

What level of benefit is adequate and how should adequacy be determined?

- In relation to what retirees need to maintain pre-retirement standards of living both in terms of health and income?
- In comparison to the benefits available to other public or private sector employees?
- By some other measure?

To whom should an adequate level of benefit be made available? Should the comprehensiveness of a benefit depend on employees':

- Age;
- Years of service; or
- Status as a public safety or miscellaneous employee or retiree?

To what extent should an adequate level of benefit be provided through employer-sponsored or employer-paid programs?

## Costs

What are reasonable costs for post-employment benefits? Should reasonableness be determined:

- In relation to the costs of similar benefits in other states and in the private sector;
- In relation to state and local governments' ability to pay; or
- By some other measure?

How should costs be distributed among employers and employees? Should the portion of the pension, health and other benefits paid for by employee contributions be based on factors such as age, years of service, or the employee's status as a public safety or miscellaneous member?

How can risks and volatility associated with investment returns and the fluctuating costs of health care and other post-employment benefits be managed effectively?

How should risks and volatility be distributed? Should it depend on factors such as employees' age, years of service, or status as a public safety or miscellaneous employee? How can benefit plans and contributions be structured to distribute volatility and risk fairly?

How should costs and benefits be weighed relative to what some view as the moral duty of government employers to model good employment practices by providing adequate retirement, health and other benefits or, conversely, by what others view as the moral obligation of government employers to give individuals the freedom to manage the funds that are set aside to pay for their benefits?

## Control

- To what extent should decisions about the design and administration of post-employment benefits be shaped by statute, by collective bargaining, by plan trustees or by voters?
- How should post-employment benefit plans be governed? How might different types of governance structures affect the cost and comprehensiveness of post-employment benefits as well as transparency and accountability with respect to administrative and investment decisions?
- How much individual responsibility, employee freedom and control should be built into the design of public employee pension, health and other post employment benefits?
- As Baby Boomers begin to exit the state and local government work force in increasing numbers, what types of post-employment benefit plan provisions and features would be most effective in terms of attracting and retaining good employees?

# Appendix A:

## Additional Resources

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### **Retiree Health Care and Other Post-Employment Benefits (OPEB)**

A Plain Language Summary of GASB Statements No. 43 and No. 45

[http://www.gasb.org/project\\_pages/opeb\\_summary.pdf](http://www.gasb.org/project_pages/opeb_summary.pdf)

"Benefits in the Balance: The Uncertain Future of Public Retiree Health Coverage," The California Health Care Foundation, 2006.

<http://www.chcf.org/documents/insurance/PublicRetireeHealthCoverage.pdf>

"Retiree Health Care: A Growing Cost for Government," California Legislative Analyst's Office, February 2006.

[http://www.lao.ca.gov/2006/ret\\_hlthcare/retiree\\_healthcare\\_021706.pdf](http://www.lao.ca.gov/2006/ret_hlthcare/retiree_healthcare_021706.pdf)

"An Analysis of Public Sector Health Care Costs in California," The Center for Government Analysis, September 2006.

<https://www.govanalyst.com/articles/CGAPublicHealthCost.pdf>

"Public Retiree Health Coverage: A Bibliography," California Health Care Foundation, 2006.

<http://www.chcf.org/documents/insurance/RetireeAdditionalResources.pdf>

### **Public Employee Pensions**

"The Gathering Pension Storm: How Government Pension Plans are Breaking the Bank and Strategies for Reform," George Passantino and Adam B. Summers, Reason Foundation Policy Study 335, June 2005.

<http://www.reason.org/ps335.pdf>

"NASRA Response to the Reason Foundation Study, 'The Gathering Pension Storm,'" Keith Brainard, National Association of State Retirement Administrators, January 2006.

[http://www.ncpers.org/artman/uploads/nasra\\_s\\_response\\_to\\_reason\\_foundation.pdf](http://www.ncpers.org/artman/uploads/nasra_s_response_to_reason_foundation.pdf)

"The Value of Defined Benefit Plans," American Academy of Actuaries Issue Brief, July 2006.

<http://www.nasra.org/resources/AAA%20Issue%20Brief%20-%20The%20Value%20of%20DB%20Plans.pdf>

"The Economic Effects of Public Pensions," National Association of State Retirement Administrators, 2004. <http://www.nasra.org/resources/NASRA%20economics%20of%20public%20pensions.pdf>

## **National Trends in Post-employment Benefits for Private- and Public-Sector Employees**

“Retirement Plan Participation: Survey of Income and Program Participation (SIPP) Data,” Employee Benefit Research Institute, September 2005.

[http://www.ebri.org/pdf/notespdf/EBRI\\_Notes\\_09-20051.pdf](http://www.ebri.org/pdf/notespdf/EBRI_Notes_09-20051.pdf)

“Public Fund Survey Summary of Findings for FY 2005,” Keith Brainard, Research Director, National Association of State Retirement Administrators, September 2006.

<http://www.publicfundsurvey.org/publicfundsurvey/pdfs/Summary%20of%20Findings%20FY05.pdf>

“2004 Comparative Study of Major Public Employee Retirement Systems,” William Ford, Senior Staff Attorney, Wisconsin Legislative Council, December 2005.

[http://www.legis.state.wi.us/lc/publications/crs/2004\\_retirement.pdf](http://www.legis.state.wi.us/lc/publications/crs/2004_retirement.pdf)

“Defined Contribution Experience in the Public Sector,” Mark C. Olleman, International Foundation of Employee Benefit Plans, February 2007.

[http://www.urs.org/general/pdf/dc\\_in\\_public\\_sector.pdf](http://www.urs.org/general/pdf/dc_in_public_sector.pdf)

## **California Pension System Annual Reports**

State Controller’s Office Public Retirement System Annual Report

<http://www.sco.ca.gov/ard/local/locprep/retirement/reports/retirement0304.pdf>

CalPERS Comprehensive Annual Financial Report

[https://www.calpers.ca.gov/mss-publication/pdf/x2N8fzn-MvFGq5\\_CAFR2006.pdf](https://www.calpers.ca.gov/mss-publication/pdf/x2N8fzn-MvFGq5_CAFR2006.pdf)

CalSTRS Comprehensive Annual Financial Report

[http://www.calstrs.com/help/forms\\_publications/printed/Current-CAFR/CAFR.aspx](http://www.calstrs.com/help/forms_publications/printed/Current-CAFR/CAFR.aspx)

Annual Financial Report of the University of California Retirement System

[http://atyourservice.ucop.edu/forms\\_pubs/misc/ar97ucrp.pdf](http://atyourservice.ucop.edu/forms_pubs/misc/ar97ucrp.pdf)

## **Perspectives from the Credit Rating Industry**

“The Not So Golden Years: Credit Implications of GASB 45,” Fitch Ratings, June 22, 2005.

<http://www.iaff.org/secure/pdfs/gasbFitch.pdf>

“Improved U.S. State Pension Funding Levels Could be on the Horizon,” Parry Young, Standard & Poor’s, February 27, 2007.

<http://www.sbafla.com/pdf%5Cnews%5CS&PFundReport.pdf>

“Reversal of Fortune: The Rising Cost of Public Sector Pensions and Other Post-Employment Benefits,” Joseph D. Mason, Fitch Ratings, September 18, 2003.

<http://www.rigfoa.org/pdf/FitchPensions.pdf>

# Appendix B:

# GASB

# Statements

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The summaries contained in this appendix were written by the Governmental Accounting Standards Board and can be found online at: <http://www.gasb.org/st/index.html>.

## summary of statement no. 45

### Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions

(ISSUED 6/04)

In addition to pensions, many state and local governmental employers provide other postemployment benefits (OPEB) as part of the total compensation offered to attract and retain the services of qualified employees. OPEB includes postemployment healthcare, as well as other forms of postemployment benefits (for example, life insurance) when provided separately from a pension plan. This Statement establishes standards for the measurement, recognition, and display of OPEB

expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers.

The approach followed in this Statement generally is consistent with the approach adopted in Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, with modifications to reflect differences between pension benefits and OPEB. Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, addresses financial statement and disclosure requirements for reporting by administrators or trustees of OPEB plan assets or by employers or sponsors that include OPEB plan assets as trust or agency funds in their financial reports.

### How this Statement Improves Financial Reporting

Postemployment benefits (OPEB as well as pensions) are part of an exchange of salaries and benefits for employee services rendered. Of the total benefits offered by employers to attract and retain qualified employees, some benefits, including salaries and active-employee healthcare, are taken while the employees are in active service, whereas other benefits, including postemployment healthcare and other OPEB, are taken after the employees' services have ended. Nevertheless, both types of benefits constitute compensation for employee services.

From an accrual accounting perspective, the cost of OPEB, like the cost of pension benefits, generally should be associated with the periods in which the exchange occurs, rather than with the periods (often many years later) when benefits are paid or provided. However, in current practice, most OPEB plans are financed on a pay-as-you-go



basis, and financial statements generally do not report the financial effects of OPEB until the promised benefits are paid. As a result, current financial reporting generally fails to:

- Recognize the cost of benefits in periods when the related services are received.
- Provide information about the actuarial accrued liabilities for promised benefits associated with past services and whether and to what extent those benefits have been funded.
- Provide information useful in assessing potential demands on the employer's future cash flows.
- This Statement improves the relevance and usefulness of financial reporting by (a) requiring systematic, accrual-basis measurement and recognition of OPEB cost (expense) over a period that approximates employees' years of service and (b) providing information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan.

## Summary of Standards

### Measurement (the Parameters)

Employers that participate in single-employer or agent multiple-employer defined benefit OPEB plans (sole and agent employers) are required to measure and disclose an amount for annual OPEB cost on the accrual basis of accounting. Annual OPEB cost is equal to the employer's annual required contribution to the plan (ARC), with certain adjustments if the employer has a net OPEB obligation for past under- or over-contributions.

The ARC is defined as the employer's required contributions for the year, calculated in accordance with certain parameters, and includes (a) the normal cost for the year and (b) a component for amortization of the total unfunded actuarial accrued liabilities (or funding excess) of the plan over a period not to exceed 30 years. The parameters

include requirements for the frequency and timing of actuarial valuations as well as for the actuarial methods and assumptions that are acceptable for financial reporting. If the methods and assumptions used in determining a plan's funding requirements meet the parameters, the same methods and assumptions are required for financial reporting by both a plan and its participating employer(s). However, if a plan's method of financing does not meet the parameters (for example, the plan is financed on a pay-as-you-go basis), the parameters nevertheless apply for financial reporting purposes.

For financial reporting purposes, an actuarial valuation is required at least biennially for OPEB plans with a total membership (including employees in active service, terminated employees who have accumulated benefits but are not yet receiving them, and retired employees and beneficiaries currently receiving benefits) of 200 or more, or at least triennially for plans with a total membership of fewer than 200. The projection of benefits should include all benefits covered by the current substantive plan (the plan as understood by the employer and plan members) at the time of each valuation and should take into consideration the pattern of sharing of benefit costs between the employer and plan members to that point, as well as certain legal or contractual caps on benefits to be provided. The parameters require that the selection of actuarial assumptions, including the healthcare cost trend rate for postemployment healthcare plans, be guided by applicable actuarial standards.

### Alternative Measurement Method

A sole employer in a plan with fewer than 100 total plan members (including employees in active service, terminated employees who have accumulated benefits but are not yet receiving them, and retirees and beneficiaries currently receiving benefits) has the option to apply a simplified alternative measurement method instead of obtaining actuarial valuations. The option also is available to an agent employer with fewer than 100 plan members, in

circumstances in which the employer's use of the alternative measurement method would not conflict with a requirement that the agent multiple-employer plan obtain an actuarial valuation for plan reporting purposes. Those circumstances are:

- The plan issues a financial report prepared in conformity with the requirements of Statement 43 but is not required to obtain an actuarial valuation because (a) the plan has fewer than one hundred total plan members (all employers) and is eligible to use the alternative measurement method, or (b) the plan is not administered as a qualifying trust, or equivalent arrangement, for which Statement 43 requires the presentation of actuarial information.
- The plan does not issue a financial report prepared in conformity with the requirements of Statement 43.

This alternative method includes the same broad measurement steps as an actuarial valuation (projecting future cash outlays for benefits, discounting projected benefits to present value, and allocating the present value of benefits to periods using an actuarial cost method). However, it permits simplification of certain assumptions to make the method potentially usable by nonspecialists.

### Net OPEB Obligation—Measurement

An employer's net OPEB obligation is defined as the cumulative difference between annual OPEB cost and the employer's contributions to a plan, including the OPEB liability or asset at transition, if any. (Because retroactive application of the measurement requirements of this Statement is not required, for most employers the OPEB liability at the beginning of the transition year will be zero.) An employer with a net OPEB obligation is required to measure annual OPEB cost equal to (a) the ARC, (b) one year's interest on the net OPEB obligation, and (c) an adjustment to the ARC to offset the effect of actuarial amortization of past under- or over-contributions.

## Financial Statement Recognition and Disclosure

Sole and agent employers should recognize OPEB expense in an amount equal to annual OPEB cost in government-wide financial statements and in the financial statements of proprietary funds and fiduciary funds from which OPEB contributions are made. OPEB expenditures should be recognized on a modified accrual basis in governmental fund financial statements. Net OPEB obligations, if any, including amounts associated with under- or over-contributions from governmental funds, should be displayed as liabilities (or assets) in government-wide financial statements. Similarly, net OPEB obligations associated with proprietary or fiduciary funds from which contributions are made should be displayed as liabilities (or assets) in the financial statements of those funds.

Employers are required to disclose descriptive information about each defined benefit OPEB plan in which they participate, including the funding policy followed. In addition, sole and agent employers are required to disclose information about contributions made in comparison to annual OPEB cost, changes in the net OPEB obligation, the funded status of each plan as of the most recent actuarial valuation date, and the nature of the actuarial valuation process and significant methods and assumptions used. Sole and agent employers also are required to present as RSI a schedule of funding progress for the most recent valuation and the two preceding valuations, accompanied by notes regarding factors that significantly affect the identification of trends in the amounts reported.

### Cost-Sharing Employers

Employers participating in cost-sharing multiple-employer plans that are administered as trusts, or equivalent arrangements, in which (a) employer contributions to the plan are irrevocable, (b) plan assets are dedicated to providing benefits to retirees and their beneficiaries in accordance with the terms of the plan, and (c) plan assets are legally

protected from creditors of the employers or plan administrator, should report as cost-sharing employers. Employers participating in multiple-employer plans that do not meet those criteria instead are required to apply the requirements of this Statement that are applicable to agent employers.

Cost-sharing employers are required to recognize OPEB expense/expenditures for their contractually required contributions to the plan on the accrual or modified accrual basis, as applicable. Required disclosures include identification of the way that the contractually required contribution rate is determined (for example, by statute or contract or on an actuarially determined basis). Employers participating in a cost-sharing plan are required to present as RSI schedules of funding progress and employer contributions for the plan as a whole if a plan financial report, prepared in accordance with Statement 43, is not issued and made publicly available and the plan is not included in the financial report of a public employee retirement system or another entity.

### Other Guidance

Employers that participate in defined contribution OPEB plans are required to recognize OPEB expense/expenditures for their required contributions to the plan and a liability for unpaid required contributions on the accrual or modified accrual basis, as applicable.

This Statement also includes guidance for employers that finance OPEB as insured benefits (as defined by this Statement) and for special funding situations.

### Effective Dates and Transition

This Statement generally provides for prospective implementation—that is, that employers set the beginning net OPEB obligation at zero as of the beginning of the initial year. Implementation is required in three phases based on a government's total annual revenues in the first fiscal year ending

after June 15, 1999. The definitions and cutoff points for that purpose are the same as those in Statement 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments. This Statement is effective for periods beginning after December 15, 2006, for phase 1 governments (those with total annual revenues of \$100 million or more); after December 15, 2007, for phase 2 governments (those with total annual revenues of \$10 million or more but less than \$100 million); and after December 15, 2008, for phase 3 governments (those with total annual revenues of less than \$10 million). Earlier implementation is encouraged.

## summary of statement no. 43

### Financial Reporting for Post-Employment Benefit Plans Other than Pension Plans

(ISSUED 4/04)

In addition to pensions, many state and local governmental employers provide other postemployment benefits (OPEB) as part of the total compensation offered to attract and retain the services of qualified employees. OPEB includes postemployment healthcare, as well as other forms of postemployment benefits (for example, life insurance) when provided separately from a pension plan.

### What this Statement Does

This Statement establishes uniform financial reporting standards for OPEB plans and supersedes the interim guidance included in Statement 26, Financial Reporting for Post-Employment Healthcare Plans Administered by Defined Benefit Pension Plans. The approach followed in this Statement generally is consistent with the approach adopted in Statement 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, with modifications to reflect differences between pension plans and OPEB plans.

The standards in this Statement apply for OPEB trust funds included in the financial reports of plan sponsors or employers, as well as for the stand-alone financial reports of OPEB plans or the public employee retirement systems, or other third parties, that administer them. This Statement also provides requirements for reporting of OPEB funds by administrators of multiple-employer OPEB plans, when the fund used to accumulate assets and pay benefits or premiums when due is not a trust fund. A related Statement, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, addresses standards for the measurement, recognition, and display of employers' OPEB expense/expenditures and related liabilities (assets); note disclosures; and, if applicable, required supplementary information (RSI). The measurement and disclosure requirements of the two Statements are related, and disclosure requirements are coordinated to avoid duplication when an OPEB plan is included as a trust or agency fund in an employer's financial report. In addition, reduced disclosures are acceptable for OPEB trust or agency funds when a stand-alone plan financial report is publicly available and contains all required information.

## summary of standards

### **OPEB Plans that are Administered as Trusts (or Equivalent Arrangements)**

#### **Financial Reporting Framework**

The financial reporting framework for defined benefit OPEB plans that are administered as trusts or equivalent arrangements includes two financial statements and two multi-year schedules that are required to be presented as RSI immediately following the notes to the financial statements. The financial statements focus on reporting current financial information about plan net assets held in trust for OPEB and financial activities related to the administration of the trust. The statement of plan net assets provides information about the

fair value and composition of plan assets, plan liabilities and plan net assets held in trust for OPEB. The statement of changes in plan net assets provides information about the year-to-year changes in plan net assets, including additions from employer, member, and other contributions and net investment income and deductions for benefits and refunds paid, or due and payable, and plan administrative expenses.

Required notes to the financial statements include a brief plan description, a summary of significant accounting policies and information about contributions and legally required reserves. In addition, OPEB plans are required to disclose information about the current funded status of the plan as of the most recent actuarial valuation date, and actuarial methods and assumptions used in the valuation.

The required schedules provide actuarially determined historical trend information from a long-term perspective (a minimum of three valuations) about the funded status of the plan, the progress being made in accumulating sufficient assets to pay benefits when due and employer contributions to the plan. The schedule of funding progress reports the actuarial value of assets, the actuarial accrued liability, and the relationship between the two over time. The schedule of employer contributions reports the annual required contributions (ARC) of the employer(s) and the percentage of ARC recognized by the plan as contributions. The required schedules are accompanied by notes regarding factors that significantly affect the identification of trends in the amounts reported.

#### **Measurement (the Parameters)**

Plans are required to measure all actuarially determined information included in their financial reports in accordance with certain parameters. The parameters include requirements for the frequency and timing of actuarial valuations as well as for the actuarial methods and assumptions that are acceptable for financial reporting. If the

methods and assumptions used in determining a plan's funding requirements meet the parameters, the same methods and assumptions are required for financial reporting by both a plan and its participating employer(s). However, if a plan's method of financing does not meet the parameters (for example, the plan is financed on a pay-as-you-go basis), the parameters apply, nevertheless, for financial reporting purposes.

For financial reporting purposes, an actuarial valuation is required at least biennially for OPEB plans with a total membership (including employees in active service, terminated employees who have accumulated benefits but are not yet receiving them and retired employees and beneficiaries currently receiving benefits) of 200 or more, and at least triennially for plans with a total membership of fewer than 200. The projection of benefits should include all benefits covered by the current substantive plan (the plan as understood by the employer and plan members) at the time of each valuation and should take into consideration the pattern of sharing of benefit costs between the employer and plan members to that point, as well as certain legal or contractual caps on benefits to be provided. The parameters require that the selection of actuarial assumptions, including the healthcare cost trend rate for postemployment healthcare plans, be guided by applicable actuarial standards.

#### **Alternative Measurement Method**

OPEB plans with a total membership of fewer than 100 have the option to apply a simplified alternative measurement method instead of obtaining actuarial valuations. This alternative method includes the same broad measurement steps as an actuarial valuation (projecting future cash outlays for benefits, discounting projected benefits to present value, and allocating the present value of projected benefits to periods using an actuarial cost method). However, it permits simplification of certain assumptions to make the method potentially usable by nonspecialists.

## **OPEB Plans That Are Not Administered as Trusts or Equivalent Arrangements**

Multiple-employer defined benefit OPEB plans that are not administered as trusts or equivalent arrangements should be reported as agency funds. Any assets accumulated in excess of liabilities to pay premiums or benefits, or for investment or administrative expenses, should be offset by liabilities to participating employers. Required notes to the financial statements include a brief plan description, a summary of significant accounting policies and information about contributions.

### **Defined Contribution Plans**

Defined contribution plans that provide OPEB are required to follow the requirements for financial reporting by fiduciary funds generally, and by component units that are fiduciary in nature, set forth in Statement 34 and the disclosure requirements set forth in paragraph 41 of Statement 25.

### **Effective Dates and Transition**

The requirements of this Statement for OPEB plan reporting are effective one year prior to the effective date of the related Statement for the employer (single-employer plan) or for the largest participating employer in the plan (multiple-employer plan). The requirements of the related Statement are effective in three phases based on a government's total annual revenues, as defined in that Statement, in the first fiscal year ending after June 15, 1999—the same criterion used to determine a government's phase for implementation of Statement 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments. Plans in which the sole or largest participating employer is a phase 1 government (those with total annual revenues of \$100 million or more) are required to implement this Statement in financial statements for periods beginning after December 15, 2005. Plans in which the sole or

largest participating employer is a phase 2 government (total annual revenues of \$10 million or more but less than \$100 million) are required to implement this Statement in financial statements for periods beginning after December 15, 2006. Plans in which the sole or largest participating employer is a phase 3 government (total annual revenues of less than \$10 million) are required to implement this Statement in financial statements for periods beginning after December 15, 2007. If comparative financial statements are presented, restatement of the prior-year financial statements is required. Early implementation of this Statement is encouraged.

## **summary of statement no. 27**

### **Accounting for Pensions by State and Local Governmental Employers**

(ISSUED 11/94)

#### **Summary**

This Statement establishes standards for the measurement, recognition, and display of pension expenditures/expense and related liabilities, assets, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. Reporting requirements for pension trust funds of employers are included in two related Statements: No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, and No. 26, Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans.

Employers that participate in single-employer and agent multiple-employer defined benefit pension plans (sole and agent employers) are required to measure and disclose an amount for annual pension cost on the accrual basis of accounting, regardless of the amount recognized as pension expenditures/expense on the modified accrual or accrual basis. Annual pension cost should be

equal to the employer's annual required contributions (ARC) to the plan, unless the employer has a net pension obligation (NPO) for past under- or over-contributions.

The ARC is defined as the employer's required contributions for the year, calculated in accordance with certain parameters. The parameters include requirements for the frequency and timing of actuarial valuations as well as for the actuarial methods and assumptions that are acceptable for financial reporting. When the methods and assumptions used in determining a plan's funding requirements meet the parameters, the same methods and assumptions are required for financial reporting by both a plan and its participating employer(s).

An NPO is defined as the cumulative difference between annual pension cost and the employer's contributions to a plan, including the pension liability or asset at transition, if any. An employer with an NPO should measure annual pension cost equal to (a) the ARC, (b) one year's interest on the NPO, and (c) an adjustment to the ARC to offset the effect of actuarial amortization of past under- or over-contributions.

The calculation requirements for the pension liability or asset at transition are similar to the requirements for calculating the NPO after the effective date. For some employers, the requirements include recalculation of any differences between the employer's actuarially determined required contributions and the contributions made, for all fiscal years beginning between December 15, 1986, and the effective date of this Statement.

Pension expenditures of governmental and expendable trust funds and all other entities that apply governmental fund accounting should be recognized on the modified accrual basis. A liability balance in the NPO should be recognized in the general long-term debt account group; an



asset balance should not be recognized in the financial statements but should be disclosed. Pension expense of proprietary and similar trust funds and all other entities that apply proprietary fund accounting, and pension expenditures of colleges and universities that apply the American Institute of Certified Public Accountants (AICPA) College Guide model, should be recognized on the accrual basis; NPO balances should be recognized as fund liabilities or assets.

In addition to descriptive information about the plan and its funding policy, the required disclosures include three years of information about annual pension cost and, if applicable, the components of annual pension cost, the increase or decrease for the year in the NPO, and the year-end balance of the NPO. Information about the plan's funding progress for the past three actuarial valuations, calculated in accordance with the parameters, should be reported as required supplementary information. Information for one or more of those valuations may be disclosed in the notes to the financial statements. However, unless the note disclosures include all three valuations, the information also should be reported as required supplementary information.

Employers that participate in cost-sharing multiple-employer defined benefit pension plans are required to recognize pension expenditures/expense equal to the employer's contractually required contributions and a liability for unpaid contributions. Recognition should be on the modified accrual or accrual basis, depending on the fund type or type of entity. Previously recognized pension liabilities should be adjusted at the effective date to equal the pension liability at transition, if any. That amount should be equal to the employer's contractually required contributions that are unpaid at the effective date. In addition to descriptive information about the plan and its funding policy, the required disclosures include three years of information about the employer's required contributions and the percentage contributed.

Employers that participate in defined contribution plans are required to recognize pension expenditures/expense equal to the employer's required contributions to the plan and a liability for unpaid contributions. Recognition should be on the modified accrual or accrual basis, depending on the fund type or type of entity. The required disclosures include descriptive information about the plan and the required and actual contributions of the employer and plan members.

This Statement also includes guidance for employers that participate in insured plans and for entities that are legally responsible for contributions to pension plans covering employees of other entities. Guidance also is provided for sole and agent employers that elect to apply the pension measurement provisions of this Statement to postemployment healthcare benefits on an interim basis, pending issuance of a future Statement(s) on accounting for those benefits.

The provisions of this Statement are effective for periods beginning after June 15, 1997. Early implementation is encouraged.

## summary of statement no. 26

### Financial Reporting for Post-Employment Healthcare Plans Administered by Defined Benefit Pension Plans

(ISSUED 11/94)

#### Summary

This Statement establishes financial reporting standards for postemployment healthcare plans administered by state and local governmental defined benefit pension plans. It is an interim Statement pending completion of the GASB's project on accounting and financial reporting of other postemployment benefits by plans and employers. Financial reporting requirements for pension assets and

benefits administered by defined benefit pension plans are included in related Statement 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans (pension plan reporting standards).

This Statement requires defined benefit pension plans that administer postemployment healthcare plans to present (a) a statement of postemployment healthcare plan net assets, (b) a statement of changes in postemployment healthcare plan net assets, and (c) notes to the financial statements, all in accordance with the pension plan reporting standards. This Statement also establishes certain requirements for plans that elect to provide historical trend information about the funded status of the postemployment healthcare plan and the employer's required contributions to the plan, either as supplementary information or in an additional financial statement(s) or notes. However, presentation of that information is not required.

The provisions of this Statement are effective for periods beginning after June 15, 1996. Early implementation is encouraged; however, Statement 25 should be implemented in the same fiscal year.

## summary of statement no. 25

### Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans

(ISSUED 11/94)

#### Summary

This Statement establishes financial reporting standards for defined benefit pension plans and for the notes to the financial statements of defined contribution plans of state and local governmental entities. Financial reporting standards for postemployment healthcare plans administered by defined benefit pension plans and for the pension expenditures/expense of employers are included, respec-



tively, in two related Statements: No. 26, Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans, and No. 27, Accounting for Pensions by State and Local Governmental Employers.

The standards in this Statement apply for pension trust funds included in the financial reports of plan sponsors or employers as well as for the stand-alone financial reports of pension plans or the public employee retirement systems that administer them. Reduced disclosures are acceptable for pension trust funds when a stand-alone plan financial report is publicly available and contains all required information.

This Statement establishes a financial reporting framework for defined benefit pension plans that distinguishes between two categories of information: (a) current financial information about plan assets and financial activities and (b) actuarially determined information, from a long-term perspective, about the funded status of the plan and the progress being made in accumulating sufficient assets to pay benefits when due.

Plans should include information in the first category in two financial statements: (a) a statement of plan net assets that provides information about the fair value and composition of plan assets, plan liabilities, and plan net assets and (b) a statement of changes in plan net assets that provides information about the year-to-year changes in plan net assets. The requirements for the notes to the financial statements include a brief plan description, a summary of significant accounting policies, and information about contributions, legally required reserves, and investment concentrations.

Information in the second category should be included, for a minimum of six years, in two schedules of historical trend information that should be presented as required supplementary information immediately after the notes to the financial statements. The required schedules are (a) a schedule of funding progress that reports the actuarial value of assets, the actuarial accrued liability, and the relationship between the two over time and (b) a schedule of employer contributions that provides information about the annual required contributions (ARC) of the employer(s) and the percentage of the ARC recognized by the plan as contributed. Note disclosures related to the required schedules should be presented after the schedules and should include the actuarial methods and significant assumptions used for financial reporting.

Plans may elect to report one or more years of the information required for either or both schedules in an additional financial statement(s) or in the notes to the financial statements. Information for all required years also should be reported as required supplementary information, unless all years are included in the additional statement(s) or notes.

Plans should measure all actuarially determined information included in their financial reports in accordance with certain parameters. The parameters include requirements for the frequency and timing of actuarial valuations as well as for the actuarial methods and assumptions that are acceptable for financial reporting. When the methods and assumptions used in determining a plan's funding requirements meet the parameters, the same methods and assumptions are required for financial reporting by both a plan and its participating employer(s).

This Statement requires the notes to the financial statements of defined contribution plans to include a brief plan description, a summary of significant accounting policies (including the fair value of plan assets, unless reported at fair value), and information about contributions and investment concentrations.

The provisions of this Statement are effective for periods beginning after June 15, 1996. Early implementation is encouraged; however, Statement 26, if applicable, should be implemented in the same fiscal year.



# Appendix C:

# A Glossary of

# Post-Employment

# Benefit Terms

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The definitions in this glossary come from a variety of online sources including:

- The State of Washington's Office of the State Actuary;  
[http://osa.leg.wa.gov/About\\_Pensions/Glossary.htm#](http://osa.leg.wa.gov/About_Pensions/Glossary.htm#)
- <http://www.knowyourpension.org/glossary.aspx>
- The Pensions Trust;  
<http://www.thepensionstrust.org.uk/TPT/website/PensionGlossary/PensionGlossary.htm>

## **Active Member**

A member of a pension system who is accruing benefits through current service.

## **Actuarial Accrued Liability (AAL)**

Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date. The AAL can be thought of as the value of benefits already earned in exchange for employees' past service.

## **Actuarial Assumptions**

Factors which actuaries use in estimating the cost of funding a defined benefit pension plan. Examples include: the rate of return on plan investments; mortality rates; and the rates at which plan participants are expected to leave the system because of retirement, disability, termination, etc.

## **Actuarial Present Value of Total Projected Benefits (APVTPB)**

The total projected costs to finance benefits payable in the future based on members' service through the valuation date and their future service, discounted to reflect the expected effects of the time value of money. It is the amount that would have to be invested on the valuation date so that the amount invested plus investment earnings will provide sufficient assets to pay the total projected benefits when due. The APVTPB is used to calculate the Annual Required Contribution (ARC).

## **Actuarial Value of Assets (AVA)**

The value of cash, investments and other property belonging to a pension plan, as used by the actuary for the purpose of a valuation.

## **Actuarial Valuation**

Refers to an investigation by an actuary into the ability of a defined benefit pension fund to meet its liabilities. This is usually to assess the funding level and a recommended contribution rate based on comparing the actuarial value of assets and the actuarial liability.

## **“Air Time”**

Allowing employees to purchase years of service credit by paying additional contributions in exchange for higher future retirement benefits. The benefit usually requires employees to contribute an amount equal to the full actuarial value of the benefits that will be received.

## **Annual Required Contribution (ARC)**

The ARC is the actuarially determined level of employer contribution that would be required on a sustained, ongoing basis to systematically fund the normal cost and to amortize the Unfunded Actuarial Accrued Liability (UAAL) attributed to past service over a period not to exceed thirty years. It is the amount needed to pay benefits as they come due plus amortize the UAAL. The ARC has two components: Normal cost and amortization of the UAAL for both active employees and retirees. If an employer funds less (or more) than the ARC, the difference is a liability (or asset) known as the net obligation.

## **Annuitant**

A retiree or beneficiary of a retiree receiving a payment in the form of an annuity.

## **Annuity**

Periodic payments to a person, usually for life.

## **Beneficiary**

A person designated by a pension plan participant to receive all or a portion of the pension benefit after the participant dies.

## **Benefit Factor**

A percentage that is applied to an employee's years of service and final compensation to determine the employee's retirement benefit. For example, with a retirement formula that includes a benefit factor of 2 percent per year at age 60, members with 20 years of service may retire at age 60 and receive approximately 40 percent of their final compensation.

## **Cash Balance Pension Plan**

A hybrid defined benefit plan that has some of the features of a defined contribution plan. The most distinguishing feature of a cash balance pension plan is the use of a hypothetical account for each participant. The plan sponsor is responsible for investment decisions. Investment risk is borne by the plan sponsor, not the participant.

## **“Contribution Holiday”**

In years when investment returns are sufficiently high, government employers may not be required to make pension contributions (i.e., to enjoy a “holiday” from contributions).

## **Contributory Pension System**

A pension system that requires active members to make contributions toward the cost of their benefits. Unlike private sector defined benefit plans, which tend to be non-contributory, most public sector plans require employees to contribute.

## **Credited Service/Service Credit**

The total time worked that counts toward an employee's benefit. Credited service is most often the number of years worked for an employer, up to the date of plan termination, or the date of plan freeze, whichever is earlier. It could be less for certain plans and for people who worked part-time.

## **Defined Benefit (DB) Pension Plan**

A retirement plan that provides a certain guaranteed benefit to participants based on a pre-determined formula.

## **Defined Contribution (DC) Pension Plan**

An employer-sponsored plan in which contributions are made to individual participant accounts, and the final benefit consists solely of assets (including investment returns) that have accumulated in these individual accounts. Depending on the type of defined contribution plan, contributions may be made either by the employer, the participant, or both.

## **Disability Retirement**

Benefit provided to an eligible member who becomes unable to perform current or comparable job for which he is qualified by his training and experience because of injury or physical or mental illness of a permanent nature.

## **Employee Retirement Income Security Act (ERISA)**

The federal law that establishes the basic requirements for employee benefit plans. The authority for administering and enforcing ERISA is divided among three federal agencies: the Internal Revenue Service (IRS), the Department of Labor (DOL), and the Pension Benefit Guaranty Corporation (PBGC).

## **Fiduciary**

With regard to a pension plan, a person or organization with control over the plan or its assets.

## **Final Compensation or Final Average Salary**

An employee's average salary for a specific period of time which is used as part of the formula to determine retirement benefits.

## **Fully-Funded**

A pension plan with sufficient assets to pay all current and future benefits.

## **Funding Ratio**

The ratio of the value of benefits members have earned, to the value of the retirement systems' assets. Under the Government Accounting Standards Board (GASB) definition, the funded ratio of a system is the actuarial value of assets over its actuarial accrued liability.

## **Governmental Accounting Standards Board (GASB)**

GASB establishes standards of financial accounting and reporting for U.S. state and local governments.

## **Hybrid Plans**

Pension Plans that incorporate elements of both defined benefit and defined contribution plans. Hybrid plans may combine features of DB and DC plans into a single plan that provides a benefit based partly on the employee's length of service (as in a DB plan) and partly on the plan's investment return (as in a DC plan). More commonly, hybrids contain two separate plans: a traditional DB plan (normally with a lower benefit factor) and a DC plan.

## **Implicit Rate Subsidy**

This is the difference between a premium rate charged to retirees for a particular benefit and the estimated rate that would have been applicable to those retirees if that benefit was acquired for them as a separate group. Under the new GASB rules, this difference is used to calculate unfunded OPEB liability. This means that employers that do not pay for retiree health benefits may still have to report OPEB liabilities if retirees are pooled together with active members in a benefit plan.

## **Joint-and-Survivor Annuity**

An annuity paying one individual for his or her life and then providing for an annuity for the person's surviving spouse, usually in a reduced amount.

## **Maximum Guaranteed Benefit**

Under the law, the largest monthly amount PBGC can pay a participant from its funds.

## **Normal Cost**

Computed differently under different funding methods, the employers' annual normal cost represents the present value of benefits that have accrued on behalf of the members during the valuation year.

## **Non-Contributory Plan**

A retirement system in which no contributions are required of its members to aid in its financing.

## **Normal Retirement Age**

The age, as established by a plan, when unreduced benefits can be received.

## **Other post-employment benefits (OPEB)**

OPEB includes post-employment healthcare, as well as other forms of post-employment benefits (for example, life insurance) provided separately from a pension plan.

## **Participant/Member**

A person who is or may become eligible to receive a benefit from a pension plan.

## **Pay-As-You-Go**

A method of recognizing the costs of a retirement system only as benefits are paid. Also known as the current disbursement cost method.

## **Pension Benefit**

A benefit payable as an annuity to a participant or beneficiary of a pension plan.

## **Pension Benefit Guaranty Corporation (PBGC)**

A federal government agency that insures private defined benefit pension plans.

## **Pension "Spiking"**

Employee practices that some refer to as "gaming" the system in order to boost the calculation of final compensation (and thus pension benefits). Includes the redemption of large amounts of unused vacation time just prior to retirement, or retiring shortly after receiving a raise or a promotion.

## **Plan assets**

Resources that have been segregated and restricted in a trust, or an equivalent arrangement, in which: (a) employer contributions to the plan are irrevocable; (b) assets are dedicated to providing benefits to retirees and their beneficiaries; and (c) assets are legally protected from creditors of the employer(s) or plan administrator, for the payment of benefits in accordance with the terms of the plan.



## **Plan liabilities**

Obligations payable by the plan at the reporting date including, primarily, benefits and refunds due and payable to plan members and beneficiaries, and accrued investment and administrative expenses. Plan liabilities do not include actuarial accrued liabilities for benefits that are not due and payable at the reporting date.

## **Portability**

The ability of an employee who changes jobs to transfer his or her accrued benefits from the previous to the present employer's pension system.

## **Pre-Funding**

A method of funding in which a reserve fund is accumulated in advance of paying benefits. This is the opposite of "pay-as-you-go".

## **Public Employees' Medical and Hospital Care Act (PEMHCA)**

California's Public Employees' Medical and Hospital Care Act directs the administration of the CalPERS Health Program. It is part of the California Government Code, Section 22751 et seq.

## **Public Employees' Retirement Law (PERL)**

The part of the California Government Code (Section 20000 et seq.) that governs CalPERS programs and services.

## **Reciprocal Agreement**

An agreement between two public retirement systems on coordination of benefits.

## **Service Credit**

A member's credited years of employment with employers covered by a pension plan. Service credit is typically used to determine vesting, eligibility for various benefits and the amount of a member's annuity.

## **Super-Funded**

A condition existing when the actuarial value of assets exceeds the present value of benefits. When this condition exists on a given valuation date for a given plan, employee contributions for the rate year covered by that valuation may be waived.

## **Survivor**

A dependent eligible to receive a benefit upon a member's death.

## **"Thirteenth" Check**

The practice of disbursing excess pension fund investment returns to beneficiaries in the form of a thirteenth check.

## **Trustee**

A person or organization with a duty to receive, manage, and disburse the assets of a plan.

## **Under-Funded**

If assets are less than accrued liabilities (i.e., insufficient assets to pay all benefits that have accrued to participants) the plan has unfunded liabilities and is deemed under-funded.

## **Unfunded Actuarial Accrued Liability (UAAL)**

The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.

## **Vested benefits (vested)**

Benefits to which an employee is entitled under a pension plan by satisfying age and/or service requirements.

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- 16 See GASB Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans (November 1994); GASB Statement No. 26, Financial Reporting for Postemployment Health-care Plans Administered by Defined Benefit Pension Plans (November 1994); and GASB Statement No. 27, Accounting for Pensions by State and Local Governmental Employers (November 1994); <http://www.gasb.org/st/stpg.html>.
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